Mechanical Technology, Incorporated

A New York Corporation
Listed on the OTC Markets quotation system on the OTC Pink – Current Information tier

Current Trading Symbol: MKTY
CUSIP Number: 583538202

Quarterly Report

For the Three and Six Months Ended
June 30, 2018 and 2017

Including Consolidated Financial Statements and Notes and Disclosures Prescribed by OTC Pink Market

Filed on July 26, 2018

1) Name of the issuer and its predecessors (if any)

Mechanical Technology, Incorporated (the "Company")

2) Address of the issuer's principal executive offices

<u>Company Headquarters</u>
Address 1: 325 Washington Avenue Extension
Address 2: Albany, NY 12205
Phone: 518.218.2550
Email: contact@mechtech.com
Website(s): https://www.mechtech.com/

<u>IR Contact</u>
Address 1: 325 Washington Avenue Extension
Address 2: Albany, NY 12205
Phone: 518.218.2550
Email: contact@mechtech.com
Website(s): https://www.mechtech.com/

3) Security Information

Trading Symbol: MKTY
Exact title and class of securities outstanding: Common Stock
CUSIP: 583538202
Par or Stated Value: $0.01
Total shares authorized: 75,000,000 as of: 06/30/18
Total shares outstanding: 9,381,677 as of: 06/30/18

Additional class of securities (if necessary):
Trading Symbol: N/A
Exact title and class of securities outstanding: N/A
CUSIP: N/A
Par or Stated Value: N/A
Total shares authorized: N/A as of: N/A
Total shares outstanding: N/A as of: N/A

<u>Transfer Agent</u>
Name: American Stock Transfer & Trust Company, LLC
Address 1: 6201 15th Avenue
Address 2: Brooklyn, NY 11219
Phone: 800.937.5449
Is the Transfer Agent registered under the Exchange Act?* Yes: X No: ☐

*To be included in the OTC Pink Current Information tier, the transfer agent must be registered under the Exchange Act.

List any restrictions on the transfer of security:

NONE

Describe any trading suspension orders issued by the SEC in the past 12 months.

NONE

List any stock split, stock dividend, recapitalization, merger, acquisition, spin-off, or reorganization either currently anticipated or that occurred within the past 12 months:

NONE

On October 6, 2016, the Company and American Stock Transfer & Trust Company, LLC, as Rights Agent, entered into a Rights Agreement (the "Rights Agreement"). The Rights Agreement is intended to act as a deterrent to any person (together with all affiliates and associates of such person) acquiring "beneficial ownership" (as defined in the Rights Agreement) of 4.99% or more of the outstanding shares of Common Stock without the approval of the Board of Directors (an "Acquiring Person"), in an effort to protect against a possible limitation on the Company's ability to use its net operating loss carryforwards. The Rights Agreement exempts Brookstone XXIV and its affiliates and associates from the definition of an Acquiring Person. The Rights Agreement is filed as Exhibit 4.1 to the Form 8-K filed by the Company with the Securities and Exchange Commission on October 6, 2016. Amendment No. 1 to the Rights Agreement is filed as Exhibit 4.2 to the Form 8-K filed by the Company with the Securities and Exchange Commission on October 21, 2016.

4) Issuance History

The list below includes any events, in chronological order, that resulted in changes in total shares outstanding by the issuer in the past two fiscal years and any interim period. The list includes all offerings of equity securities, including debt convertible into equity securities, whether private or public, and all shares or any other securities or options to acquire such securities issued for services, describing (1) the securities, (2) the persons or entities to whom such securities were issued and (3) the services provided by such persons or entities.

Issuances to Employees and Directors:

From January 1, 2018 through June 30, 2018, certain of the employees and directors of the Company exercised options to purchase an aggregate of 18,195 shares of Common Stock at an exercise price of $0.29 per share. Such options were awarded to these employees and directors for services provided to the Company and pursuant to registration statements filed with the Securities and Exchange Commission.

From January 1, 2016 through December 31, 2017, the Company awarded to certain of its employees and directors options to purchase an aggregate of 263,000 shares of Common Stock at an exercise price of $0.78 per share. Such options were awarded to these employees and directors for services provided to the Company and pursuant to registration statements filed with the Securities and Exchange Commission.

From January 1, 2016 through December 31, 2017, certain of the employees and directors of the Company exercised options to purchase an aggregate of 365,000 shares of Common Stock at exercise prices ranging from $0.29 to $1.40 per share. Such options were awarded to these employees and directors for services provided to the Company and pursuant to registration statements filed with the Securities and Exchange Commission.

Issuance to Brookstone XXIV:

On October 21, 2016, the Company issued and sold 3,750,000 shares of Common Stock to Brookstone Partners Acquisition XXIV, LLC ("Brookstone XXIV"), for an aggregate of $2,737,500, pursuant to a private placement transaction conducted in reliance upon the exemption from registration provided by Section 4(a)(2) of the Securities Act of 1933, as amended, and Rule 506 promulgated thereunder. The certificate evidencing such shares contain a legend (1) stating that the shares have not been registered under the Securities Act, (2) referring to the restrictions on transferability and sale of the shares under the Securities Act, and (3) referring to the restrictions on transferability and sale of the shares under the Rights Agreement.

5) Financial Statements

The information called for by this Item 5 is included following the "Index to Consolidated Financial Statements" contained in this quarterly report.

6) Describe the Issuer's Business, Products and Services

A. Description of the Business Operations

The Company's core business is conducted through MTI Instruments, Inc. ("MTI Instruments"), its wholly-owned subsidiary. MTI Instruments was incorporated in New York on March 8, 2000 and is a supplier of precision linear displacement solutions, vibration measurement and system balancing systems, and wafer inspection tools, consisting of electronic gauging instruments for position, displacement and vibration application within the industrial manufacturing/production markets, as well as the research, design and process development market; tensile stage systems for materials testing at academic and industrial research settings; and engine vibration analysis systems for both military and commercial aircraft. These tools, systems and solutions are developed for markets and applications that require the precise measurements and control of products, processes, and the development and implementation of automated manufacturing, assembly, and consistent operation of complex machinery.

B. Date and State (or Jurisdiction) of Incorporation

October 3, 1961, New York

C. Primary and Secondary SIC Codes

3829

D. Fiscal Year End Date

December 31

E. Principal Products or Services and Their Markets

We offer precision measurement products in the following categories:

Non-Contact Measurement
Non-contact displacement sensing can be accomplished by a variety of sensors such as eddy current, capacitance, laser triangulation, confocal chromatic and fiber optic. Since non-contact sensing doesn't touch the part, there is no part loading and no marks or dents are left on the target being measured.

Products: 1D Laser; 2D-3D Laser' Capacitance Sensors' Fiber Optic Sensors

Turbine Engine / Rotating Machine Balancing
Our turbine engine and rotating machine systems for measurement and balancing are used by global leaders in the engine propulsion and power generation industries.

Products: Vibration and Balancing Systems' Engine Signal Conditioning; Charge Amplifiers

Diagnostics
Encased in a rugged shell, our portable signal generator is ideal for system troubleshooting, testing, and calibrating electronic equipment and machinery monitoring systems. It simulates eddy current, accelerometer, strain gauge and other types of pulse, sinusoidal, triangle, or digital pulse trains.

Products: Portable Signal Generator

Semiconductor / Solar Metrology Systems
We offer manual and semi-automated metrology systems for the solar and semiconductor industries. These capacitance based systems, built around the Company's proprietary push/pull technology, provide non-contact measurement of thickness, TTV, and bow/warp. Applications include the fabrication of solar/photovoltaic, semiconducting, and semi-insulating wafers.

Products: Manual Semiconductor Metrology System; Semi-automated Metrology System; Photovoltaic/Solar Metrology System

Tensile Systems
Our tensile systems cover a wide range of load capabilities with a flexible design, and are in use in many of the most popular scanning electron microscopes (SEMs), light microscopes (LMs), and atomic force microscopes (AFMs).

Products: SEM/LM-based Tensile Systems; AFM/LM-based Tensile Systems

OEM / Custom Solutions
For OEMs with more tailored precision displacement needs, we offer rapid-deployment custom measurement solutions. The building block of our custom systems is the Accumeasure platform of amplifiers which can be custom-made to match specific performance needs. This platform provides exceptional value and offers sub-

nanometer resolution, extremely high stability, and fast response time, making it ideal for many different applications including micro-positioning, thermal correction, focusing and closed-loop applications.

Our tools and solutions are developed for markets that require the precise measurements and control of products processes for the development and implementation of automated manufacturing, assembly, and consistent operation of complex machinery. The Company has moved to a customer and market-based approach by targeting leading companies in specific market segments including the industrial and consumer electronics, automotive and other precision automated manufacturing industries, turbo machinery and the research and development aspects within these markets for both product and process improvements. Ongoing efforts to improve engine performance and lower fuel consumption drive both military and commercial axial turbo-machinery operators to maintain their equipment at peak performance.

See our website at https://www.mtiinstruments.com/products/ for more information regarding our business, products, and services.

7) Describe the Issuer's Facilities

We lease approximately 17,400 square feet of office, manufacturing and research and development space at 325 Washington Avenue Extension, Albany, NY 12205. The current lease agreement expires on November 30, 2019. We believe our facilities are generally well maintained and adequate for our current needs and for expansion, if required.

We lease two copier/printers. The current lease agreement expires in June 2020.

We lease a storage facility on a month-to-month basis from an independent third party.

8) Officers, Directors, and Control Persons

A. Names of Officers, Directors, and Control Persons

As of the date of this report, below are the names of each of the Company's executive officers, directors, general partners and control persons of more than five percent (5%) of any class of our equity securities.

Executive Officers and Directors:

Frederick Jones – Chief Executive Officer and Chief Financial Officer
David C. Michaels – Chairman of the Board
Edward R. Hirshfield – Director
Matthew E. Lipman – Director
Thomas J. Marusak – Director
William P. Phelan – Director
Michael Toporek – Director

Control Persons:

As the owner of approximately 40% of the outstanding shares of Common Stock of the Company, Brookstone XXIV may be deemed to be a Control Person of the Company. As the Managing Member of Brookstone XXIV, BP XXIV Flow, LLC ("Brookstone Flow") may be deemed to beneficially own the shares of Common Stock owned directly by Brookstone XXIV. As the Managing Member of Brookstone Flow, BP XXIV Meter, LLC ("Brookstone Meter") may be deemed to beneficially own the shares of Common Stock owned directly by Brookstone XXIV. As the Managing Member of Brookstone Meter, Edward R. Hirshfield may be deemed to beneficially own the shares of Common Stock owned directly by Brookstone XXIV. Accordingly, each of Brookstone Flow, Brookstone Meter and Mr. Hirshfield may also be deemed to be a Control Person of the Company. Each of Brookstone Flow, Brookstone Meter and Mr. Hirshfield disclaims beneficial ownership of the shares of Common Stock owned directly by Brookstone XXIV except to the extent of his or its pecuniary interest therein.

Michael Toporek is the President and Chief Executive Officer of each of Brookstone XXIV, Brookstone Flow and Brookstone Meter. Matthew E. Lipman is the Vice President of each of Brookstone XXIV, Brookstone Flow and Brookstone Meter.

B. Legal/Disciplinary History

None of the foregoing persons have, in the last five years, been the subject of:

1. A conviction in a criminal proceeding or named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses);

2. The entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended or otherwise limited such person's involvement in any type of business, securities, commodities, or banking activities;

3. A finding or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, or a state securities regulator of a violation of federal or state securities or commodities law, which finding or judgment has not been reversed, suspended, or vacated; or

4. The entry of an order by a self-regulatory organization that permanently or temporarily barred suspended or otherwise limited such person's involvement in any type of business or securities activities.

C. Beneficial Shareholders

Below is a list of the names, addresses and shareholdings or the percentage of shares owned by all persons or entities beneficially owning more than ten percent (10%) of any class of the issuer's equity securities.

Brookstone XXIV owns directly approximately 40% of the outstanding shares of Common Stock of the Company. As the Managing Member of Brookstone XXIV, Brookstone Flow may be deemed to beneficially own the shares of Common Stock owned directly by Brookstone XXIV. As the Managing Member of Brookstone Flow, Brookstone Meter may be deemed to beneficially own the shares of Common Stock owned directly by Brookstone XXIV. As the Managing Member of Brookstone Meter, Edward R. Hirshfield may be deemed to beneficially own the shares of Common Stock owned directly by Brookstone XXIV. Each of Brookstone Flow, Brookstone Meter and Mr. Hirshfield disclaims beneficial ownership of the shares of Common Stock owned directly by Brookstone XXIV except to the extent of his or its pecuniary interest therein. The address of each of Brookstone XXIV, Brookstone Flow, Brookstone Meter and Mr. Hirshfield is 122 East 42nd Street, Suite 4305, New York, New York 10168. The resident agent of Brookstone XXIV is United States Corporation Agents, Inc., 300 Delaware Avenue, Suite 210-A, Wilmington, Delaware 19801.

9) Third Party Providers

Below is a list of names, addresses, telephone numbers, and email address of each of the following outside providers that advise our company on matters relating to operations, business development and disclosure:

<u>Legal Counsel</u>
Name: Penny Somer-Greif
Firm: Baker, Donelson, Caldwell & Berkowitz, PC
Address 1: 100 Light Street
Address 2: Baltimore, MD 21202
Phone: 410.862.1141
Email: psomergreif@bakerdonelson.com

Name: Brian P. Murphy
Firm: Couch White LLP
Address 1: 540 Broadway, 7th Floor
Address 2: Albany, NY 12207
Phone: 518.426.4600
Email: bmurphy@couchwhite.com

Name: Jeffrey S. Spindler
Firm: Olshan Frome Wolosky LLP
Address 1: 1325 Avenue of the Americas
Address 2: New York, NY 10019
Phone: 212.451.2300
Email: jspindler@olshanlaw.com

Accountant or Auditor
Name: Eric Hennessey
Firm: UHY LLP
Address 1: 4 Tower Place, Executive Park, 7th Floor
Address 2: Albany, NY 12203
Phone: 518.449.3166
Email: ehennessey@uhy-us.com

Name: Frank Ferrucci
Firm: Wojeski & Company CPAs, P.C.
Address 1: 75 Troy Road
Address 2: East Greenbush, NY 12061
Phone: 518.694.8007
Email: fferrucci@wojeskico.com

Investor Relations Consultant
Name: N/A
Firm: ______
Address 1: ______
Address 2: ______
Phone: ______
Email: ______

Other Advisor: Any other advisor(s) that assisted, advised, prepared or provided information with respect to this disclosure statement.
Name: N/A
Firm: ______
Address 1: ______
Address 2: ______
Phone: ______
Email: ______

10) Issuer Certification

I, Frederick Jones certify that:

1. I have reviewed this Quarterly Disclosure Statement of Mechanical Technology, Incorporated;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

July 26, 2018

/s/ Frederick Jones

/s/ Frederick Jones

CEO and CFO

MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
INDEX

Mechanical Technology, Incorporated and Subsidiaries
Condensed Consolidated Balance Sheets
As of June 30, 2018 (Unaudited) and December 31, 2017

(Dollars in thousands, except per share)		June 30, 2018		December 31, 2017
Assets				
Current Assets:				
Cash	$	4,562	$	3,828
Accounts receivable – less allowances of $2 in both 2018 and 2017		927		1,406
Inventories		778		694
Prepaid expenses and other current assets		30		90
Total Current Assets		6,297		6,018
Property, plant and equipment, net		204		184
Total Assets	$	6,501	$	6,202
Liabilities and Stockholders' Equity				
Current Liabilities:				
Accounts payable	$	231	$	325
Accrued liabilities		905		913
Deferred income taxes payable		19		—
Total Current Liabilities		1,155		1,238
Commitments and Contingencies (Note 8)				
Stockholders' Equity:				
Common stock, par value $0.01 per share, authorized 75,000,000; 10,397,170 issued in 2018 and 10,378,975 issued in 2017		104		104
Additional paid-in capital		139,031		139,022
Accumulated deficit		(120,025)		(120,398)
Common stock in treasury, at cost, 1,015,493 shares in both 2018 and 2017		(13,764)		(13,764)
Total Stockholders' Equity		5,346		4,964
Total Liabilities and Stockholders' Equity	$	6,501	$	6,202

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Mechanical Technology, Incorporated and Subsidiaries
Condensed Consolidated Statements of Operations (Unaudited)
For the Three and Six Months Ended June 30, 2018 and 2017

(Dollars in thousands, except per share)	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Product revenue	$ 2,021	$ 1,893	$ 3,609	$ 3,190
Operating costs and expenses:				
Cost of product revenue	593	537	1,026	1,041
Research and product development expenses	285	296	552	610
Selling, general and administrative expenses	761	747	1,649	1,635
Operating income (loss)	382	313	382	(96)
Other income (expense), net	5	—	10	(5)
Income (loss) before income taxes	387	313	392	(101)
Income tax (expense) benefit	(19)	—	(19)	—
Net income (loss)	$ 368	$ 313	$ 373	$ (101)
Income (loss) per share (Basic)	$ .04	$ .03	$ .04	$ (.01)
Income (loss) per share (Diluted)	$ .04	$ .03	$ .04	$ (.01)
Weighted average shares outstanding (Basic)	9,380,441	9,137,497	9,374,714	9,081,451
Weighted average shares outstanding (Diluted)	9,439,473	9,398,330	9,442,992	9,081,451

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Mechanical Technology, Incorporated and Subsidiaries
Condensed Consolidated Statements of Changes in Equity
For the Year Ended December 31, 2017
and the Six Months Ended June 30, 2018 (Unaudited)

(Dollars in thousands, except per share)	Common Stock				Treasury Stock		
	Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Shares	Amount	Total Stockholders' Equity (Deficit)
January 1, 2017	10,026,136	$ 100	$ 138,794	$ (120,980)	1,015,493	$ (13,764)	$ 4,150
Net income	-	-	-	582	-	-	582
Stock based compensation	-	-	41	-	-	-	41
Costs of stock purchase	-	-	(25)	-	-	-	(25)
Issuance of shares – option exercises	352,839	4	212	-	-	-	216
December 31, 2017	10,378,975	$ 104	$ 139,022	$ (120,398)	1,015,493	$ (13,764)	$ 4,964
Net income	-	-	-	373	-	-	373
Stock based compensation	-	-	4	-	-	-	4
Issuance of shares – option exercises	18,195	-	5	-	-	-	5
June 30, 2018	10,397,170	$ 104	$ 139,031	$ (120,025)	1,015,493	$ (13,764)	$ 5,346

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Mechanical Technology, Incorporated and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)
For the Six Months Ended June 30, 2018 and 2017

(Dollars in thousands)

	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Operating Activities		
Net income (loss)	$ 373	$ (101)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	46	41
Stock based compensation	4	31
Provision for excess and obsolete inventories	(20)	(36)
Changes in operating assets and liabilities:		
Accounts receivable	479	(194)
Inventories	(64)	15
Prepaid expenses and other current assets	60	18
Accounts payable	(94)	232
Accrued liabilities	(8)	(51)
Deferred income taxes payable	19	—
Net cash provided by (used in) operating activities	795	(45)
Investing Activities		
Purchases of equipment	(66)	(14)
Net cash used in investing activities	(66)	(14)
Financing Activities		
Costs of stock purchase	—	(25)
Proceeds from stock option exercises	5	101
Net cash provided by financing activities	5	76
Increase in cash	734	17
Cash – beginning of period	3,828	3,381
Cash – end of period	$ 4,562	$ 3,398

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Nature of Operations

Description of Business

Mechanical Technology, Incorporated (MTI or the Company), a New York corporation, was incorporated in 1961. The Company's core business is conducted through MTI Instruments, Inc. (MTI Instruments), a wholly-owned subsidiary.

MTI Instruments was incorporated in New York on March 8, 2000 and is a supplier of precision linear displacement solutions, vibration measurement and system balancing systems, and wafer inspection tools, consisting of electronic gauging instruments for position, displacement and vibration application within the industrial manufacturing/production markets, as well as the research, design and process development market; tensile stage systems for materials testing at academic and industrial research settings; and engine vibration analysis systems for both military and commercial aircraft. These tools, systems and solutions are developed for markets and applications that require the precise measurements and control of products, processes, and the development and implementation of automated manufacturing, assembly, and consistent operation of complex machinery.

Liquidity

The Company has historically incurred significant losses primarily due to its past efforts to fund direct methanol fuel cell product development and commercialization programs, and had a consolidated accumulated deficit of approximately $120.0 million as of June 30, 2018. As of June 30, 2018, the Company had working capital of approximately $5.1 million, no debt, $3 thousand in commitments for capital expenditures, and approximately $4.6 million of cash available to fund our operations.

Based on the Company's projected cash requirements for operations and capital expenditures, its current available cash of approximately $4.6 million and its projected 2018 and 2019 cash flows pursuant to management's plans, management believes it will have adequate resources to fund operations and capital expenditures for the year ending December 31, 2018 and through the end of the third quarter of 2019. If cash generated from operations is insufficient to satisfy the Company's operational working capital and capital expenditure requirements, the Company may be required to obtain credit facilities, if available, to fund these initiatives. The Company has no other formal commitments for funding future needs of the organization at this time and any additional financing during 2018 and through the end of the third quarter of 2019, if required, may not be available to us on acceptable terms or at all.

2. Basis of Presentation

In the opinion of management, the Company's condensed consolidated financial statements reflect all adjustments, which are of a normal recurring nature, necessary for a fair statement of the results for the periods presented in accordance with United States of America Generally Accepted Accounting Principles (U.S. GAAP). The results of operations for the interim periods presented are not necessarily indicative of results for the full year.

Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

The information presented in the accompanying condensed consolidated balance sheet as of December 31, 2017 has been derived from the Company's audited consolidated financial statements. All other information has been derived from the Company's unaudited condensed consolidated financial statements for the three and six months ended June 30, 2018 and June 30, 2017.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, MTI Instruments. All intercompany balances and transactions are eliminated in consolidation.

Revenue Recognition

Product revenue consists of revenue recognized from MTI Instruments' product lines. Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

If the product requires that we provide installation, all revenue related to the product is deferred and recognized upon the completion of the installation. If the product requires specific customer acceptance criteria, such as on-site customer acceptance and/or acceptance after install, then revenue is deferred until customer acceptance occurs or the acceptance provisions lapse, unless the Company can objectively and reliably demonstrate that the criteria specified in the acceptance provisions is satisfied. The Company may also record unearned revenues, which include payments for other offerings for which we have been paid in advance. The resulting revenue would be earned when we transfer control of the product or service. As of June 30, 2018 and December 31, 2017, the Company had no deferred or unearned revenue.

MTI Instruments currently has distributor agreements in place for the international sale of general instrument and semiconductor products in certain global regions. Such agreements grant a distributor the right of first refusal to act as distributor for such products in the distributor's territory. In return, the distributor agrees to not market other products which are considered by MTI Instruments to be in direct competition with MTI Instruments' products. The distributor is allowed to purchase MTI Instruments' equipment at a price which is discounted off the published domestic/international list prices. Such list prices can be adjusted by MTI Instruments during the term of the distributor agreement. Generally, payment terms with the distributor are standard net 30 days; however, on occasion, extended payment terms have been granted. Title and risk of loss of the product passes to the distributor upon delivery to the independent carrier (standard "free-on-board" factory), and the distributor is responsible for any required training and/or service with the end-user. The sale (and subsequent payment) between MTI Instruments and the distributor is not contingent upon the successful resale of the product by the distributor. Distributor sales are covered by MTI Instruments' standard one-year warranty and there are no special return policies for distributors.

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. We determine the standalone selling price (SSP) for each distinct performance obligation. Since we sell our products and services separately, the SSP is directly observable.

Trade accounts receivable are stated at the invoiced amount billed to customers and do not bear interest. An allowance for doubtful accounts, if necessary, represents the Company's best estimate of the amount of probable credit losses in its existing accounts receivable. The Company determines the allowance based on historical write-off experience and current exposures identified. The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectability. All other balances are reviewed on a pooled basis by type of receivable. Account balances are charged off against the allowance when the Company believes it is probable the receivable will not be recovered. The Company does not have any off-balance-sheet credit exposure related to its customers. Our allowance for doubtful accounts was $2 thousand at June 30, 2018 and December 31, 2017.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers.

We recognize an asset for the incremental costs of obtaining a contract with a customer, if we expect the benefit of those costs to be longer than one year. As of June 30, 2018 and December 31, 2017, we have recorded no capitalized costs to obtain a contract.

We apply a practical expedient to expense costs as incurred for costs to obtain a contract when the amortization period would have been one year or less. These costs include our internal sales force compensation programs as we have determined annual compensation is commensurate with annual sales activities.

3. Accounts Receivable

Accounts receivables consist of the following at:

(Dollars in thousands)	June 30, 2018	December 31, 2017
U.S. and State Government	$ 290	$ 221
Commercial	639	1,187
Allowance for doubtful accounts	(2)	(2)
Total	$ 927	$ 1,406

For the six months ended June 30, 2018 and 2017, the largest commercial customer represented 19.4% and 8.6%, respectively, and the largest governmental agency represented 20.1% and 27.6%, respectively, of the Company's product revenue. As of June 30, 2018 and December 31, 2017, the largest commercial receivable represented 17.8% and 23.0%, respectively, and the largest governmental receivable represented 31.2% and 15.7%, respectively, of the Company's accounts receivable.

4. Inventories

Inventories consist of the following at:

(Dollars in thousands)	June 30, 2018	December 31, 2017
Finished goods	$ 256	$ 214
Work in process	209	174
Raw materials	313	306
Total	$ 778	$ 694

5. Property, Plant and Equipment

Property, plant and equipment consist of the following at:

(Dollars in thousands)	June 30, 2018	December 31, 2017
Leasehold improvements	$ 39	$ 39
Computers and related software	1,020	971
Machinery and equipment	898	881
Office furniture and fixtures	34	34
	1,991	1,925
Less: Accumulated depreciation	1,787	1,741
	$ 204	$ 184

Depreciation expense was $46 thousand and $81 thousand for the six months ended June 30, 2018 and the year ended December 31, 2017, respectively.

6. Income Taxes

The 2017 Tax Act was signed into law on December 22, 2017 and significantly revised the U.S. corporate income tax regime by, among other things, lowering the statutory corporate tax rate from 35% to 21%, eliminating certain deductions, imposing a mandatory one-time tax on accumulated earnings of foreign subsidiaries, introducing new tax regimes, changing how foreign earnings are subject to U.S. tax and limiting the amount of net operating losses (NOLs) that can be utilized in a given tax year. The 2017 Tax Act also enhanced and extended through 2026 the option to claim accelerated depreciation deductions on qualified property. The Company completed its determination of the accounting implications of the 2017 Tax Act on its tax accruals and reasonably estimated the effects of the 2017 Tax Act and recorded provisional amounts in its financial statements as of December 31, 2017. The Company recorded a $7.2 million adjustment with a corresponding full valuation allowance adjustment to our net deferred tax liabilities for the impact of the 2017 Tax Act. This amount is comprised of the remeasurement of federal net deferred tax liabilities resulting from the permanent reduction in the U.S. statutory corporate tax rate to 21% from 35%. As the Company interprets any additional guidance issued by the U.S. Treasury Department, the IRS, and other standard-setting bodies, the Company may make adjustments to the provisional amounts. Those adjustments may materially impact our provision for income taxes in the period in which the adjustments are made.

During the three and six months ended June 30, 2018, the Company's effective income tax rate was 5%. The projected annual effective tax rate is less than the Federal statutory rate of 21%, primarily due to the change in the valuation allowance, as well as changes to estimated taxable income for 2018 and permanent differences. For the three and six months ended June 30, 2017, the Company's effective income tax rate was 0%. Income tax expense for the three and six months ended June 30, 2018 was $19 thousand and there was no income tax expense for the three and six months ended June 30, 2017.

The Company provides for recognition of deferred tax assets if the realization of such assets is more likely than not to occur in accordance with accounting standards that address income taxes. Significant management judgment is required in determining the period in which the reversal of a valuation allowance should occur. The Company has considered all available evidence, both positive and negative, such as historical levels of income and future forecasts of taxable income amongst other items, in determining its valuation allowance. In addition, the Company's assessment requires us to schedule future taxable income in accordance with accounting standards that address income taxes to assess the appropriateness of a valuation allowance which further requires the exercise of significant management judgment.

The Company believes that the accounting estimate for the valuation of deferred tax assets is a critical accounting estimate, because judgment is required in assessing the likely future tax consequences of events that have been recognized in our financial statements or tax returns. The Company based the estimate of deferred tax assets and liabilities on current tax laws and rates and, in certain cases, business plans and other expectations about future outcomes. In the event that actual results differ from these estimates or the Company adjusts these estimates in future periods, the Company may need to adjust the recorded valuation allowance, which could materially impact our financial position and results of operations. The Company has recorded a full valuation allowance at June 30, 2018 and December 31, 2017 for its deferred tax assets. The valuation allowance was $11.6 million and $11.7 million at June 30, 2018 and December 31, 2017, respectively. We will continue to evaluate the ability to realize our deferred tax assets and related valuation allowance on a quarterly basis.

7. Stockholders' Equity

Common Stock

The Company has one class of common stock, par value $.01. Each share of the Company's common stock is entitled to one vote on all matters submitted to stockholders. As of June 30, 2018 and December 31, 2017, there were 9,381,677 and 9,363,482 shares of common stock, respectively, issued and outstanding.

Reservation of Shares

The Company had reserved common shares for future issuance as follows as of June 30, 2018:

Stock options outstanding	646,374
Common stock available for future equity awards or issuance of options	154,431
Number of common shares reserved	800,805

Income (Loss) per Share

The Company computes basic income (loss) per common share by dividing net income (loss) by the weighted average number of common shares outstanding during the reporting period. Diluted income (loss) per share reflects the potential dilution, if any, computed by dividing income (loss) by the combination of dilutive common share equivalents, comprised of shares issuable under outstanding investment rights, warrants and the Company's share-based compensation plans, and the weighted average number of common shares outstanding during the reporting period. Dilutive common share equivalents include the dilutive effect of in-the-money stock options, which are calculated based on the average share price for each period using the treasury stock method. Under the treasury stock method, the exercise price of a stock option and the amount of compensation cost, if any, for future service that the Company has not yet recognized are assumed to be used to repurchase shares in the current period.

Not included in the computation of earnings per share, assuming dilution, for the six months ended June 30, 2018, were options to purchase 425,749 shares of the Company's common stock. These potentially dilutive items were excluded because the exercise prices of these options are greater than the average market share price and their inclusion would have been anti-dilutive. Not included in the computation of earnings per share, assuming dilution, for the three months ended June 30, 2018, were options to purchase 479,124 shares, respectively of the Company's common stock. These potentially dilutive items were excluded because the exercise prices of these options are greater than the average market share price and their inclusion would have been anti-dilutive.

Not included in the computation of earnings per share, assuming dilution, for the six months ended June 30, 2017, were options to purchase 985,553 shares of the Company's common stock. These potentially dilutive items were excluded because the Company incurred a loss during the period and their inclusion would be anti-dilutive. Not included in the computation of earnings per share, assuming dilution, for the three months ended June 30, 2017, were options to purchase 273,589 shares, respectively of the Company's common stock. These potentially dilutive items were excluded even though the average market price of the common stock exceeded the exercise prices for a portion of the options because the calculation of incremental shares resulted in an anti-dilutive effect.

8. Commitments and Contingencies

Commitments:

Leases

The Company and its subsidiary lease certain manufacturing, laboratory and office facilities. The lease provides for the Company to pay its allocated share of insurance, taxes, maintenance and other costs of the leased property.

Future minimum rental payments required under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2018 are: $112 thousand remaining in 2018; $209 thousand in 2019 and $3 thousand in 2020.

Warranties

Product warranty liabilities are included in "Accrued liabilities" in the Condensed Consolidated Balance Sheets. Below is a reconciliation of changes in product warranty liabilities:

(Dollars in thousands)	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Balance, January 1	$ 14	$ 14
Accruals for warranties issued	9	8
Settlements made (in cash or in kind)	(4)	(10)
Balance, end of period	$ 19	$ 12

Employment Agreement

On May 5, 2017, the Company entered into an employment agreement with one employee. The agreement provides for an initial term ending December 31, 2018, and, unless either party provides written notice that the agreement will not be renewed, is renewed for an additional year on December 31, 2018 and each subsequent December 31; such non-renewal may be for any or for no stated reason. The agreement provides for certain payments upon termination of employment under certain circumstances. As of June 30, 2018, the Company's potential minimum obligation to this employee was approximately $206 thousand.

Contingencies:

Legal

We are subject to legal proceedings, claims and liabilities which arise in the ordinary course of business. When applicable, we accrue for losses associated with legal claims when such losses are probable and can be reasonably estimated. These accruals are adjusted as additional information becomes available or circumstances change. Legal fees are charged to expense as they are incurred.

9. Related Party Transactions

MeOH Power, Inc.

The Company records its investment in MeOH Power, Inc. using the equity method of accounting. The fair value of the Company's interest in MeOH Power, Inc. has been determined to be $0 as of June 30, 2018 and December 31, 2017, based on MeOH Power, Inc.'s net position and expected cash flows. As of June 30, 2018, the Company retained its ownership of approximately 47.5% of MeOH Power, Inc.'s outstanding common stock, or 75,049,937 shares. The number of shares of MeOH Power, Inc.'s common stock authorized for issuance is 240,000,000 as of June 30, 2018.

On December 18, 2013, MeOH Power, Inc. and the Company executed a Senior Demand Promissory Note (the Note) in the amount of $380 thousand to secure the intercompany amounts due to the Company from MeOH Power, Inc. upon the deconsolidation of MeOH Power, Inc. Interest accrues on the Note at the Prime Rate in effect on the first business day of the month, as published in the Wall Street Journal. At the Company's option, all or part of the principal and interest due on this Note may be converted to shares of common stock of MeOH Power, Inc. at a rate of $0.07 per share. Interest began accruing on January 1, 2014. The Company recorded a full allowance against the Note. As of June 30, 2018 and December 31, 2017, $291 thousand and $285 thousand, respectively, of principal and interest are available to convert into shares of common stock of MeOH Power, Inc. Any adjustments to the allowance are recorded as miscellaneous expense during the period incurred.

Legal Services

During the three and six months ended June 30, 2018, the Company incurred $0 thousand and $1 thousand, respectively, to Couch White, LLP for legal services associated with contract review. During the three and six months ended June 30, 2017, the Company incurred $5 thousand and $9 thousand, respectively, to Couch White, LLP for legal services associated with contract review. A partner at Couch White, LLP is an immediate family member of one of our Directors.

10. Effect of Recent Accounting Updates

Accounting Updates Not Yet Effective

Changes to U.S. GAAP are established by the Financial Accounting Standards Board (the FASB) in the form of accounting standard updates (ASUs) to the FASB's Accounting Standards Codification (ASC). The Company considered the applicability and impact of all ASUs. ASUs not mentioned below were assessed and determined to be either not applicable or are expected to have minimal impact on our consolidated financial position or results of operations.

In February 2016, the FASB issued ASU 2016-02 (Leases (Topic 842)), which requires lessees to recognize a right-of-use asset and a lease liability on their balance sheet for virtually all of their leases (other than leases that meet the definition of a short-term lease). The lease liability will be equal to the present value of lease payments and the right-of-use asset will be based on the lease liability, subject to adjustment such as for initial direct costs. For income statement purposes, this standard retains a dual model similar to ASC 840, requiring leases to be classified as either operating or finance. For lessees, operating leases will result in straight-line expense (similar to current accounting by lessees for operating leases under ASC 840) while finance leases will result in a front-loaded expense pattern (similar to current accounting by lessees for capital leases under ASC 840). While this standard maintains similar accounting for lessors as under ASC 840, this standard reflects updates to, among other things, align with certain changes to the lessee model. This standard will be effective for the Company for annual and interim reporting periods beginning on or after December 15, 2018, and early adoption is permitted. Although we have not completed our assessment, we believe adoption of this standard may have a significant impact on our consolidated balance sheets. However, we do not expect the adoption to change the recognition, measurement or presentation of lease expense within our consolidated statements of operations or the consolidated statements of cash flows. We currently expect that most of our operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon our adoption of the standard, which will increase our total assets and total liabilities that we report relative to such amounts prior to adoption. Information about our undiscounted future lease payments and the timing of those payments is in Note 8, Commitments and Contingencies.

Accounting Updates Recently Adopted by the Company

On January 1, 2018, we adopted ASU 2014-09 (Revenue from Contracts with Customers (Topic 606)) and its subsequent amendments to the initial guidance within ASU 2015-14, ASU 2016-08, ASU 2016-10, ASU 2016-12 and ASU 2016-20, respectively (collectively, Topic 606). Topic 606 is principles-based and provides a five-step model to determine when and how revenue is recognized. Revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The Company adopted this standard on a retrospective basis with no cumulative effect recognized as of January 1, 2018. The adoption of this standard did not have a material impact on its consolidated financial statements.

On January 1, 2018, we adopted ASU 2016-01 (Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities) the main objective of which is to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information and address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The adoption of this standard did not have a material impact on its consolidated financial statements.

On January 1, 2018, we adopted ASU 2016-15 (Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments), which clarifies the treatment of several cash flow categories. In addition, ASU 2016-15 clarifies that when cash receipts and cash payments have aspects of more than one class of cash flows and cannot be separated, classification will depend on the predominant source or use. The Company adopted this standard on a retrospective transition method to each period presented. The adoption of this standard did not have a material impact on its consolidated financial statements.

On January 1, 2018, we adopted ASU 2017-09 (Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting), which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The Company adopted this standard on a prospective basis to any award modified on or after the adoption date. The adoption of this standard did not have a material impact on its consolidated financial statements.

There have been no other significant changes in our reported financial position or results of operations and cash flows as a result of our adoption of new accounting pronouncements or changes to our significant accounting policies that were disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.